No. 80-1754

Office-Supreme Court, U.S.
FILED
JUN 2 1981
ALEXANDER L. STEVAS
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

WEBSTER A. COLLINS, HERBERT R. MORRISON, HELEN O. MORRISON, and GLEN A. WILKINSON,
Petitioners,

v.

DAVID R. JOHNSTON, THE NORTHWESTERN BANK, and JAMES R. GILLEY,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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PETITIONERS' REPLY MEMORANDUM

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PETITIONERS' REPLY MEMORANDUM

I. RESPONDENTS' CHALLENGE TO THE STANDING OF THE PETITIONERS IS UNSOUND

A new issue raised in respondents' opposing brief in No. 80-1754 concerns the standing of investors to petition this Court for a writ of certiorari. *See* Respondents' Brief at 21-27. Briefly summarized, respondents' argument is that the investors were not parties to the reorganization proceedings and were not aggrieved by the lower court's reversal of the bankruptcy court's order authorizing the trustee to pay the costs of their

litigation. This argument is based on a fundamental misunderstanding, *inter alia*, of the nature of Chapter X reorganization proceedings, as distinguished from regular bankruptcy proceedings.[1]

In a proceeding arising under Chapter X, "[t]he debtor, the indenture trustees, and *any creditor or stockholder of the debtor shall have the right to be heard on all matters* . . . ." 11 U.S.C. § 606 (1976) (emphasis added). This Court has stated that this provision creates an exception to the general rules pertaining to standing to be heard and to appeal in bankruptcy cases: "[Section] 206 of the Chandler Act . . . , contrary to the general bankruptcy procedure, grants any stockholder or creditor the right to be heard on all matters relating to corporate reorganizations. Courts have liberally construed this language as authorizing appeals." *Young* v. *Higbee Co.*, 324 U.S. 204, 210 (1945) (footnote omitted).[2]

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[1] None of the decisions cited by respondents in their argument on the standing issue involves proceedings under Chapter X. In fact, at least one of respondents' authorities comments upon the significant difference between Chapter X and other bankruptcy proceedings in the area of standing to appeal. 6 *Collier on Bankruptcy* Part 2 ¶ 9.23[2], at 1700-01 (14th ed. 1978).

[2] One of the decisions cited with approval by this Court in *Young* v. *Higbee Co.* held that shareholders and creditors need not intervene in the district court in order to have standing to appeal to the circuit court of appeals. Dana v. SEC, 125 F.2d 542, 543 (2d Cir. 1942) (per curiam) (panel of L. Hand, Chase and Clark, JJ.). Rather, creditors and stockholders may appeal from any order deciding any matter in a Chapter X proceeding. *Id.* In a subsequent decision, the Third Circuit held that a creditor who made no appearance at the hearing before the district court pertaining to an alleged fraudulent transfer of the debtor's property to that creditor nevertheless had standing to appeal the district court's order requiring it to reconvey the property to the debtor. *In re* S. Jersey Land Corp., 361 F.2d 610, 614 (3d Cir. 1966). The law on this point was recently summarized by Judge Duffy of the Southern District of New York as follows: "'[T]he right to be

As a result of section 206, creditors and stockholders "are by statute parties to the case." 6 *Collier on Bankruptcy* Part 2 ¶ 9.23[1], at 1694 (14th ed. 1978). The record clearly establishes that petitioners are stockholders and creditors[3] of the debtors herein. For purposes of Chapter X, the term "creditor" is simply defined as "the holder of any claim." 11 U.S.C. § 506(4) (1976). The term "claims" is defined to include "all claims of whatever character . . . whether or not such claims are provable under section 103 of this title and whether secured or unsecured, liquidated or unliquidated, fixed or contingent." *Id.* § 506(1).

As creditors and stockholders of the debtors, the defrauded investors have the same statutorily protected interest in the order in question as do respondents. In fact, all creditors and stockholders of the debtors have a very clear interest in the issues presented. If the bankruptcy judge's January 16 order is upheld, the trustee's expenditure of the debtors' funds for costs of the *Gilbert* action is likely to result in a substantial reduction or elimination of the claims against the estate, as well as a substantial improvement in the viability of any plan of reorganization, and the prospects for financial recovery by all creditors and stockholders will therefore be greatly enhanced.[4] Therefore, the respondents'

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heard' provided for in Section 206 and Rule 10-210(a)(1) includes the right of appeal even absent participation in the proceeding resulting in the order from which the appeal is taken." *In re* Duplan Corp., 450 F. Supp. 790, 792 (S.D.N.Y. 1978).

[3] The class plaintiffs' claims in *Gilbert* against the debtors' directors, officers and agents could also be claims against the debtors themselves. Indeed, the petitioners herein filed proofs of claims in the reorganization proceedings on September 14, 1979. Respondents' Brief at 13.

[4] Far less substantial interests have been held to confer standing to appeal orders in reorganization proceedings. *See, e.g., In re Wonderbowl, Inc.*, 515 F.2d 18, 19 (9th Cir.) (stockholder

assertion that the defrauded investors "have no rights to seek this review" is without merit.

II. RESPONDENTS RELY UPON A DECISION OF THE BANKRUPTCY COURT WHICH HAS BEEN REVERSED ON APPEAL

Respondents have cited and appended to their opposing brief the entire text of an opinion written by the bankruptcy judge on May 15, 1980, which purported to disallow the claims filed in the Chapter X proceedings by petitioners. Respondents failed to report, however, that upon appeal by the petitioners and the United States Securities and Exchange Commission, the district court has upheld petitioners' right to file claims in the Chapter X proceedings and reversed the bankruptcy judge's disallowance of those claims. Memorandum dated May 18, 1981.[5] Respondents also failed to disclose that the bankruptcy judge's May 15, 1980 order did not alter or rescind his January 16, 1979 order which is the subject of this petition. *See* Petition at 24a. Thus, the bankruptcy judge's now-reversed opinion and the unfounded statements contained therein should have no bearing on this Court's decision to grant certiorari in this case.

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whose subordinated position renders his stock worthless nevertheless has standing to appeal order approving compromise in Chapter X proceeding), *cert. denied*, 423 U.S. 869 (1975).

[5] Attached hereto as Appendix A. This memorandum was transmitted to counsel by the clerk of the district court on May 19, 1981, but counsel have previously been advised by the district court, on several occasions, that it intended to reverse the bankruptcy judge on this issue.

Respectfully submitted,

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June 1981

APPENDIX A

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF NORTH CAROLINA
OFFICE OF THE CLERK

Post Office Box V-1

Greensboro, North Carolina 27402

CARMON J. STUART, Clerk

Telephone (919) 378-5347

May 19, 1981

TO: ALL COUNSEL OF RECORD

RE: C-80-342-G; Shelton and Collins, et al. v. Gilbert, et al.
(B-77-695 etc. Appeal)

Gentlemen:

Please see the attached memorandum dated May 18, 1981, of Judge Erwin's ruling on the appeals from the Bankruptcy Court Order dated May 15, 1980.

Your proposed judgment should be submitted to this office no later than *June 8* for coordination and forwarding to Judge Erwin.

Very truly yours,

/s/ Carmon J. Stuart
CARMON J. STUART

bf

Enclosure

UNITED STATES GOVERNMENT

memorandum

Date: May 18, 1981

/s/ Richard C. Erwin

Reply to
Attn of: Richard C. Erwin, U.S. District Judge

Subject: C-80-342-G; Shelton and Collins, et al. v. Gilbert, et al. (Appeal B-77-695 etc.)

To: Mr. Carmon J. Stuart
Clerk of Court

The Court is ruling as follows on the above-referenced appeal from the May 15, 1980 order of Judge Reynolds, Bankruptcy Judge:

(1) As to the Collins, et al. claim (filed September 14, 1979):

a. Reverse Judge Reynolds as to Webster A. Collins, Herbert R. Morrison and Helen O. Morrison, W. O. Gregory, and Glen A. Wilkinson.

b. Affirm as to "[Names and addresses of all other similarly situated shareholders of the Debtors known to or reasonably ascertainable by the Trustee]."

(2) As to the Shelton, et al. claim (filed September 14, 1979):

a. Reverse Judge Reynolds as to Thomas W. Shelton, William F. Suddeth, and George W. Fulk.

b. Affirm as to "[Names and addresses of all other similarly situated employees and for-

mer employees of the Debtors known to or ascertainable by the Trustee]," *but* remand to Judge Reynolds with instructions that he consider the Proof of Multiple Claims filed October 5, 1979 by George W. Fulk in his capacity as fiduciary with respect to various profit sharing, pension, and retirement plans listed in the claim.

(3) The Court requests that all parties file a proposed judgment within twenty (20) days of this date in light of the above.

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